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IN THE

# Supreme Court of the United States.

OCTOBER TERM, 1936.

No. 500.

GUY S. MARTIN,
Petitioner,
v.
NATIONAL SURETY COMPANY et al.,
Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

## RESPONDENTS' BRIEF ON THE MERITS.

J. H. CUNNINGHAM, JR.,
Solicitor for Respondents: Alton Brick Company, James Beveridge, Mississippi Lime & Material Company, Koerner Engineering Company, Wenzil Andris, Schwartz Materials Company, Usona Manufacturing Company, Brass & Copper Sales Company, Hunkins-Willis Lime & Cement Company, The McClelland Company, H. E. Kennedy, Robert E. Lancaster, Peter Vredenburgh Lumber Company, H. H. Sandman, Masker Brothers Iron Company, St. Louis Asphalt Company, Otto G. Braun, Straub Bros., Walter G. Malham, Larry Schaff, Galloway-Von Gruenigen Company, C. F. Rabbeitt Company, Shapleigh Hardware Company, Italian Marble Company, Winkle Terra Cotta Company, Jack Hyde, Illinois Steel Bridge Company.

Of Counsel:
WILLIAM L. IGOE.

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## INDEX.


Page

I. Opinions of courts below ..... 1

II. Jurisdiction ..... 2

III. Statement of facts ..... 3

IV. Proceedings in the courts below ..... 12

V. Summary of argument ..... 16

VI. Argument ..... 21

Point A—Funds remaining in Government's hands after completion of job impressed with equitable lien in favor of unpaid laborers .... 21

1. Government has moral obligation to see that laborers are paid ..... 21

2. Requirements of bond provided by statute are impliedly part of contract ..... 22

3. One collecting funds after completion of job with actual knowledge of equitable rights of laborers acquires no superior rights ..... 29

Point B—Surety has equitable lien on funds remaining in Government's hands after the completion of the job ..... 30

1. Where principal has defaulted and has become insolvent, surety has equitable right of exoneration ..... 31

2. Assignment in favor of surety on bond required by statute is valid ..... 35

3. Where facts indicate intention to apply funds in exoneration of surety, funds are impressed in equity with lien in favor of surety ..... 38

Point C—The contractor and the assignee were in fact partners ..... 44

Point D—Agent who is liable to his principal in a transaction cannot thereafter acquire superior rights to the detriment of his principal ..... 56

Point E—Power of attorney given to Martin under express agreement to first pay laborers and funds in his hands impressed with trust in favor of laborers..... 60

Point F—The assignment to Martin was a fraudulent conveyance ..... 61

Point G—Martin's conduct gave rise to equitable estoppel in favor of surety and laborers and materialmen ..... 63

1. Assignment of power of attorney by contractor to general creditor of funds to become due from Government is void by statute ..... 64

Point H—A party must come into equity with clean hands ..... 66

**Cases Cited.**

American Surety Co. v. Westinghouse E. M. Co., 296 U. S. 133, 80 L. Ed. 31 ..... 27, 28, 57
Angle v. C. St. P. M. & O. Ry. Co., 151 U. S. 1 ..... 65
Bank of Br. N. A. v. Cooper, 137 U. S. 473, 34 L. Ed. 759 ..... 57
Batavia v. Wallace (C. C. A. 8), 102 F. 240 ..... 63
Beaugard v. Case, etc., 91 U. S. 134 ..... 47
Belknap Hdw. & Mfg. Co. v. Ohio River Contract Co. (C. C. A. 6), 271 F. 144 ..... 21, 24, 27
Brown Bonnell & Co. v. Lake Superior Iron Co., 134 U. S. 530, 33 L. Ed. 1021 ..... 66
Campbell v. Northwest Eckington Imp. Co. et al., 229 U. S. 561 ..... 47
Causey v. Cottman Co. (C. C. A. 4), 12 F. (2d) 558 .... 55
Central State Bank v. U. S. F. & G. Co. (C. C. A. 5), 9 F. (2d) 326, certiorari denied 270 U. S. 656 ..... 38
Com. Finance Corp. v. McHarg (C. C. A. 2), 282 F. 560 ..... 58
C. T. Co. et al. v. Woodbury (C. C. A. 8), 77 F. (2d) 478 ..... 63
Cosby v. Buchanan, 23 Wall. 420, 23 L. Ed. 137 ..... 64
Cox v. N. E. Equitable Ins. Co. (C. C. A. 8), 247 F. 955 ..... 22, 34
Cragin v. Powell, 128 U. S. 691, 32 L. Ed. 566 ..... 59
Dennison & Co. v. Aldrich, 114 Mo. App. 700 ..... 59
Dexter & Carpenter In. v. Houston et al. (C. C. A. 4), 20 F. (2d) 647 ..... 56
Exchange State Bank v. Federal Surety Co. (C. C. A. 8), 28 F. (2d) 485 ..... 26, 27, 36
Farmers Bank v. Hayes et al. (C. C. A. 6), 58 F. (2d) 34 (cert. denied 287 U. S. 602, 77 L. Ed. 524) ..... 25, 28

Fechtler v. Palm Bros. & Co. (C. C. A. 6), 133 F. 462.. 55
First National Bank v. City Trust Safe Deposit & Surety Co. (C. C. A. 9), 114 F. 529.....29, 35, 41
First National Bank v. Fidelity & Deposit Co. (C. C. A. 10), 65 F. (2d) 959..... 22
Geddes v. Reeves Coal & Dock Co., 20 F. (2d) 48..... 37
Glades Co. v. Detroit Fid. & Surety Co., 57 F. (2d) 449.....22, 33
Goodman v. Niblack (12 Otto), 102 U. S. 556, 26 L. Ed. 229..... 35
Grumley v. Webb, 44 Mo. 444.....59, 65
Hartford Acc. & Ind. Co. v. Coggin, 78 F. (2d) 471.... 39
Henningsen v. U. S. F. & G. Co., 143 F. 810..... 22
Henningsen v. U. S. F. & G. Co., 208 U. S. 404, 52 L. Ed. 547.....22, 28
Heyward v. Goldsmith (C. C. A. 3), 269 F. 946..... 22
Hill v. Epley, 31 Pa. St. 334..... 65
Huteson v. U. S. (C. C. A. 7th), 67 Fed. (2d) 731.... 49
Ingersoll v. Coram, 211 U. S. 335..... 38
In re P. M'Garry & Son (C. C. A. 7), 240 F. 400.....28, 34
Kirk v. Hamilton (12 Otto), 102 U. S. 68..... 65
Lacy v. Maryland Cas. Co. (C. C. A. 4), 32 F. (2d) 48..26, 41
Lay v. Lay, 248 U. S. 24..... 35
London & Lancashire Ind. Co. v. Endres et al. (C. C. A. 8), 290 F. 98..... 29
Manson v. Williams (C. C. A. 1), 153 F. 525..... 47
Maryland Cas. Co. v. Dulaney Lbr. Co. et al. (C. C. A. 5), 23 F. (2d) 378..... 29
McGowan v. Parrish, 237 U. S. 285..... 35
McNew v. Booth, 42 Mo. 189..... 65
Meehan v. Valentine, 145 U. S. 611.....45, 55
Mesker et al. v. Ohio R. Sand Co. et al., 285 F. 379 (appeal dismissed 264 U. S. 572, 68 L. Ed. 856).... 21

Moran v. Guardian Cas. Co., 76 F. (2d) 438.....29, 35, 42
Philadelphia Natl. Bank v. McKinlay, 72 F. (2d) 89..29, 39
Prairie State Natl. Bank v. U. S., 164 U. S. 227, 41 L. Ed. 412.....41, 64
Price v. Forrest, 173 U. S. 410..... 35
Re John E. Enright (C. C. A. 2d), 40 Fed. (2d) 588.. 48
Riverview State Bank v. Wentz et al. (C. C. A. 8), 34 F. (2d) 419 .....28, 29
Ruggles v. Buckley et al. (C. C. A. 6), 158 F. 950.... 55
Sexton v. Kessler & Co., 225 U. S. 90..... 38
Spofford v. Kirk, 97 U. S. 484..... 35
Trice v. Comstock (C. C. A. 8), 121 F. 620.....57, 58
U. S. F. & G. Co. v. Bank of Breuton (D. C.), 4 F. S. 272 ..... 34
U. S. F. & G. Co. v. City of Bristow et al., 4 F. (2d) 810 ..... 39
U. S. F. & G. Co. v. Sweeney (C. C. A. 8), 80 F. (2d) 235 .....27, 34
U. S. v. Carter, 217 U. S. 286..... 59
W. P. Co. v. Low (C. C. A. 8), 54 F. 93..... 63
Ward v. Thompson, 63 U. S. 330.....45, 46
Wardman v. Leopold, 85 F. (2d) 277..... 35

**Statutes Cited.**

Act of August 13, 1894, Chap. 280, 28 Stat. at L. 278; Act of February 24, 1905, Chap. 778, 33 Stat. at L. 811; Act of March 3, 1911, Chap. 231, Sec. 291, 36 Stat. at L. 1167, U. S. C. A., Title 40, Sec. 270.....5, 22
Jud. Code, Sec. 240 as amended (28 U. S. C., Sec. 347a) ..... 2
Rev. St. of Mo. (1929 Ed.), Secs. 3116-7.....61, 62
31 U. S. C., Sec. 203.....17, 35

## Other Authorities Cited.

Bispham on Equity, Par. 351 ..... 36
2 C. J., Secs. 353-4 ..... 59
37 C. J. 315-319 ..... 36
Pollack, Partnership (11th Ed.), p. 4 ..... 46
Pomeroy Eq. Juris. (3rd Ed.), Secs. 1239, 1235 ..... 36
1 Story Eq. 391 ..... 65

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

## RESPONDENTS' BRIEF ON THE MERITS.

I.

### OPINIONS OF THE COURTS BELOW.

The District Court filed no opinion in the case. The opinion of the Circuit Court of Appeals for the Eighth Circuit is reported at **85 Fed. (2) 135**, and is found in the record at pages 154-162.

## II.

## JURISDICTION.

(a) This cause is pending here on Writ of Certiorari granted by this Court on December 7, 1936, upon authority of Judicial Code, Section 240, as amended (28 U. S. C., Sec. 347a).

(b) The judgment of the Circuit Court of Appeals became final on August 17, 1936 (R. 162).

(c) The Circuit Court of Appeals affirmed the decision of the District Court in favor of respondents, upon the single point that laborers and materialmen on a federal public work have an equitable right to payment out of funds remaining due the contractor upon completion of the contract and that such rights are superior to those of a subsequent assignee of the contractor who, at best, was a general creditor; and that the surety on the contractor's bond had the right to have the money thereafter collected by such assignee from the Government applied to the payment of claims for which the surety would otherwise be liable (the contractor having become insolvent) and which, if paid by the surety, would give it a superior right to the funds by reason of subrogation. The Circuit Court of Appeals deemed it unnecessary to consider the other points raised by respondents by way of additional reasons for affrming the decree below (R. 162).

## III.

## STATEMENT OF FACTS.

The opinion of the Circuit Court of Appeals (R. 154-162) suffices as an outline of the material facts. For the convenience of the Court we restate the facts and add additional facts that appear to be of controlling importance in support of the findings and decrees of the courts below.

Petitioner Martin was an agent with authority to execute surety bonds on behalf of the National Surety Company (plaintiff below), in the early part of 1932, when the matter arose of executing a construction bond for the contractor, A. C. Tobin. In addition to his connection with the National Surety Company, Martin at that time was engaged with the contractor, Tobin, in a private venture for profit, which was described by Tobin as follows:

> "My arrangement with Mr. Martin started back at the beginning of the Havana post office job. At that time I was the low bidder, and Mr. Martin wrote the bond; my financial standing was weak. While there was nothing in writing, it was agreed that if I needed funds at any time I could get a lift from Mr. Martin. In return for that, at the completion of the various jobs, the profits were to be divided on a 50-50 basis. That arrangement commenced on the Havana job and carried right on through the Carlinville job" (R. 138).

Tobin expressly testified, in answer to the question of whether or not he had a silent partner on the Carlinville job (involved in this case), that there was an arrangement between himself and Guy S. Martin that if he (Tobin) was short of money he was to draw on Martin and Martin was to help him out from time to time, and if, at the conclusion of the job, there was a profit, that they were to split

the profit (R. 137). Tobin further expressly testified that the arrangement with Martin was that he was to be repaid for the moneys advanced by him only after the contractor had first paid all of the laborers and materialmen (R. 141). Martin's own evidence established that during the construction of the Carlinville post office the contractor, Tobin, was authorized to sign checks against Martin's bank account (R. 96). While Martin denied having a partnership arrangement with Tobin and claimed that he was merely a money lender, nevertheless he made the following significant admission:

> "I don't believe that we agreed upon any rate of interest in connection with the Tobin jobs for which I was furnishing money" (R. 143).

Numerous other significant facts relative to the partnership, found by the trial court to exist between Tobin and Martin (R. 47), will be referred to later in the argument.

When the question of executing the construction bond on the Carlinville post office arose, the National Surety Company had no knowledge of Martin's relations with the contractor Tobin, but when the vice-president of the National Surety Company heard that his company was considering executing Tobin's bond on this job, he expressly instructed his agent, Martin, petitioner herein, not to execute such bond on behalf of the National Surety Company (R. 80). Martin violated those express instructions of an executive officer of the company by whom he was employed, and executed the bond on behalf of the National Surety Company (R. 92).

Tobin's contract with the Government (R. 87-88) required him to perform all of the work required for the construction of the Carlinville post office and to furnish all labor and materials. It was executed pursuant to the pre-

visions of the statute (Act of August 13, 1894, Chap. 280, 28 Stat. at L. 278; Act of February 24, 1905, Chap. 778, 33 Stat. at L. 811; Act of March 3, 1911, Chap. 231, Sec. 291, 36 Stat. at L. 1167, U. S. C. A. Title 40, Sec. 270), requiring the execution and delivery of a bond conditioned (1) upon the performance of the contract by the contractor, and (2) upon the contractor's promptly making payment to all persons supplying labor and materials for the job. Such bond (R. 91-92), which was made and executed by the National Surety Company acting through petitioner Martin, as aforesaid, is conditioned in accordance with the provisions of the contract and in accordance with the provisions of the statute, which is expressly mentioned in the bond (R. 92).

In conjunction with this matter Martin, as agent for the Surety Company, had the contractor execute a written application for such surety bond, wherein it was expressly warranted "**that the applicant (Tobin) has not assigned and would not assign his payment on this contract, or any part thereof,**" to anyone (other than the National Surety Company) (R. 89). Said application also contained the customary assignment by the contractor to the Surety Company of all future payments, as well as the retained percentage, by way of security for the obligations assumed by the Surety Company (R. 91); and it was agreed that the contractor would deposit sufficient additional funds with the surety to cover any contingent claim or claims arising from the contractor's failure to pay them (R. 91).

The work on the Carlinville post office continued from its inception in the early part of 1932 until the Government took possession of the building on February 1, 1933 (R. 78-79). The time specified in the contract for the completion of the work was January 18, 1933, and a penalty of $35.00 per day was provided for failure to complete the

building on time (R. 79). While there remained some work to be done at the time the Government took possession of the building on February 1, 1933 (R. 79), the trial court (R. 28) and the Court of Appeals (R. 156) found that the building was substantially completed at the time the Government accepted it and took possession on February 1, 1933.

The trial court further found that in December, 1932, when Tobin, the contractor, gave Martin the power of attorney to collect the funds remaining in the Government's hands, Tobin had defaulted in his obligations under the contract with the Government requiring him "to furnish all labor and materials" and in his obligations under the bond, required by statute in connection therewith and expressly requiring the prompt payment to persons who supplied labor and materials—in that Tobin had not paid at least $15,000.00 of accrued labor and material bills (R. 29, 28).

In the fall of 1932 the contractor was getting into financial difficulties and defaulted in making payment of the accruing labor and material bills (R. 84-85). Tobin testified:

> "In December, 1932, I was getting in difficulties and I had a conversation with Mr. Hauck of the National Surety Company at that time, in which he told me that he wanted to have joint control of the balance of the funds due from the Government" (R. 107).

As a matter of fact Tobin was then insolvent, and at the hearing on the merits in March of 1933 it was established that Tobin had about $5,700.00 due from the Government and only one other resource—"a claim against the Government that probably will be settled"—whereas he was heavily involved with another surety company that had a

contingent claim against him for $35,000.00 (R. 109), and the unpaid claims of laborers and materialmen on the Carlinville job totaled $24,557.09 (R. 50-53).

During most of the period that Tobin & Company was working on the Carlinville post office job it was also working on the Havana, Illinois, post office job on which appellant Guy S. Martin also furnished Tobin with bond through another surety company (R. 103). Martin claims to have advanced money from time to time for use on the two construction jobs in question (R. 94) and contends that his Exhibit O (R. 125-127) is an accurate statement of moneys advanced by him on the Carlinville post office job. The actual facts about the matter, however, are as follows: Mr. Martin's secretary and bookkeeper testified:

> "We do not have any system or records in our office which would allocate the amount of money paid out by Mr. Tobin on the Carlinville job and on the other job; it is all in one ledger" (R. 103).

Petitioner Martin testified with respect to the matter as follows:

> "I assume that money went to the Carlinville job. I do not have any way of knowing. It was advanced to Mr. Tobin for that purpose. I do not know where it went. When I gave checks for these various amounts payable to Mr. Tobin I do not know where the money went" (R. 97-98).

While Martin's codefendant, Tobin, did testify in October of 1934, at the claims hearing, that the moneys Martin advanced "went directly into the job," yet he testified nearly two years before at a hearing on February 20, 1933 (R. 78):

> "I think the $4,716.00 (referring to a bookkeeping entry) was a Government check, and the other funds

were money obtained either through Mr. Martin or transferred probably from the Tower Grove Bank (where Martin had his bank account). I disbursed that money to pay bills, some on Havana and some on Carlinville" (R. 107).

Tobin also testified:

"As to the money paid out to material and labor men on the Carlinville job, I myself did not pay any. At the beginning of that job I had a man who paid bills and labor" (R. 106).

The total contract price was $49,500.00 (R. 88) and at the time Tobin executed the power of attorney in favor of Martin, Tobin had already collected on the job approximately $33,000.00 (R. 107). Although about 90 per cent of the entire job was subcontracted by Tobin (R. 107), and none of the subcontractors defaulted (R. 109) there remains unpaid to subcontractors, laborers and materialmen the sum of $24,557.09 (R. 50-53).

On December 20, 1932, when the Surety Company demanded joint control of the balance of the funds due from the Government (R. 83, 107), the contractor, Tobin, advised the Surety Company that he wanted to see his attorney about executing the power of attorney given to him by the Surety Company for that purpose. However, instead of executing and returning the power of attorney, Tobin took it to Martin (R. 108). The next day, December 21, 1932, Martin procured a new power of attorney, executed by Tobin to Martin (R. 99, 101). Martin also prepared a letter to the Treasury Department, which Tobin likewise signed, directing that all of Tobin's checks be forwarded to petitioner, Guy S. Martin (Exhibit H, R. 117). On December 28, 1932, Martin forwarded the power of attorney and the letter written by Tobin to the Treasury Department (R. 117).

Between December 20, 1932, and February 6, 1933, when Martin actually collected the money from the Government, various officials of the National Surety Company had conferences with Martin concerning the difficulties that had arisen by virtue of the contractor's nonpayment of labor and material bills (R. 81-83). Martin at all times concealed the fact that he had said power of attorney and affirmatively misrepresented the fact that he claimed to have money due him on account of loans made to the contractor, Tobin (R. 82, 83). The contractor, Tobin, like Mr. Martin, also actively misrepresented and concealed from the Surety Company the true facts with respect to having executed a power of attorney in favor of Martin and with respect to the fact, if it be a fact, that Tobin owed Martin any money (R. 86, 87, 108). In January, 1933, during the period of time that Martin was fraudulently concealing the fact that he had procured and forwarded to Washington a power of attorney in his own favor and was fraudulently misrepresenting to the National Surety Company that Tobin owed him no money, the National Surety Company was prepared to institute a bill in equity to protect its equitable right as the contractor's surety to be exonerated of liability on this job, and Martin had knowledge of the Surety Company's intentions at that time (R. 99).

On February 4, 1933, Tobin and his then attorney, Mr. Oliver Erbs, of the firm of Carter & Jones, called on the National Surety Company's attorneys and stated that they desired to work out a joint control of all moneys due from the Government for the purpose of paying labor and material bills (R. 86-87). The Surety Company's attorney asked them if they had secured the power of attorney in favor of the Surety Company which they had delivered to appellant Martin and Mr. Erbs advised the Surety

Company's attorney that he would secure it the following Monday (February 6, 1933). Tobin assured the Surety Company's attorney that the power of attorney in question was still in Martin's possession and that he did not have any outstanding obligations to Martin (R. 86, 87). On the afternoon of the same day, Tobin sent Martin to Washington to "collect that money for me" (R. 108). At the first hearing in this matter, which was on the application for preliminary injunction, Tobin, who was called as a witness on behalf of Martin, explains the foregoing transaction as follows:

> "The reason I did not tell you I wanted Mr. Martin to get this money and that I was going to send him to Washington to get it, was that you did not ask me and I did not have it in mind at that time. I made up my mind to send Mr. Martin to Washington on Saturday afternoon" (this was the same afternoon) (R. 108).

Mr. Martin's own explanation of his actions in this matter are set forth in detail on pages 99 through 101 of the record. Martin testified, in part, as follows:

> "**When he (Tobin) gave me the power of attorney he said there were going to be some bills to pay and he wanted me to handle these funds** (R. 99). • • •
>
> I am not sure that I notified Mr. Hauck (adjuster for the Surety Company) that I had received it. I did not notify him that I had sent it into the Treasury Department; I was under no obligation to do so. I **was interested in seeing these accounts paid** • • • (R. 99). • • •
>
> The check I received I cashed in Washington, and I brought the money home in the form of a bank draft payable to me. My motive in cashing the Government check in Washington was to get the money.

> I got it in cash and bought a draft. The money now is in the Tower Grove Bank in my account. The draft was for $10,448.10 and I deposited it in the Tower Grove Bank. I figured I have paid this account (meaning his personal loan to Tobin) out of that draft. **My account does not show that I have paid it by a credit entry.**"

It was on Monday, February 6, 1933, that appellant Martin collected the money in Washington (R. 96), as a result of the hurried trip which he made in secrecy, even from Tobin's attorneys (R. 86, 87, 101, 108), who appeared in this case as Martin's attorneys about ten days later (R. 16).

This suit was instituted on February 9, 1933 (R. 5), the day after the Surety Company learned that appellant Martin had gone to Washington and collected the money (R. 87). On February 15, 1933, appellant Martin, together with his attorney, Mr. Bull, of the firm Carter & Jones, was in the office of Mr. Mayne, attorney for the National Surety Company, when Plaintiff's Exhibit E (R. 114-115) and Plaintiff's Exhibit F (R. 116) were dictated with their tacit approval (R. 114). Exhibit E was a draft of a proposed preliminary injunction in favor of the National Surety Company against Tobin and Martin in this case, and the Plaintiff's Exhibit F was a proposed agreement in the form of a letter addressed to appellant Martin's attorneys by the National Surety Company's attorneys, wherein, among other things, it was recited:

> "Pursuant to our understanding made in connection with the above styled case in which a temporary restraining order was issued by consent, it is our understanding that Mr. Tobin and Mr. Martin will arrange to effect a settlement with the labor and material creditors on the amounts such creditors claim to be due for the construction of the Carlinville, Illinois, Post Office Building • • •"

## IV.

## PROCEEDINGS IN THE COURTS BELOW.

The amended bill of complaint (R. 6-15) sets forth the identity of the parties; the contract with the Government for the erection of the Carlinville post office; the provisions of the Federal Statute under which the contract was let requiring the execution of a bond conditioned upon prompt payment to all persons supplying labor and material; the bond furnished conditioned upon the contractor's promptly making payment to all persons supplying labor and material in the prosecution of the work; the contractor's written application to the Surety Company in connection with the execution of the Surety Bond in question, wherein it was provided that the contractor Tobin assigned to the Surety Company all the deferred payments and retained percentages, and any and all moneys and properties that may be due and payable at the time of any breach or default in said contract (and wherein it was warranted that the contractor had not assigned and would not assign his payment on this contract, or any part thereof, to anyone other than the Surety Company) (R. 89); the failure of the contractor to pay the labor and material claims during the progress of the work, and the fact that the contractor permitted claims to be made against the Surety Company on the bond alleged to be in excess of $12,000; that the contractor's work had been substantially completed and that the Government had delivered vouchers (or estimates) to Tobin for $10,448.10 covering the final work (December, 1932, and January, 1933), except the agreed retained percentage of 10 per cent; that the contractor Tobin in addition to his outstanding labor and material bills in excess of $12,000 had other obligations and no assets of any

value with which to pay either the materialmen and laborers or anyone else; that the contractor Tobin had delivered to defendant Guy S. Martin (the Surety Company's former agent, who executed the bond in question and procured the application which Tobin signed in connection with the bond) a power of attorney in favor of the said Guy S. Martin for the collection of all vouchers and checks of the Government, for the purpose of depriving the plaintiff Surety Company of collecting the balance due under the contract and applying said amount to the payment of the unpaid bills of laborers and materialmen, and that Martin had collected the sum of $10,448.10, representing said December and January vouchers, or estimates, being the final two months of the work; that demand had been made upon Martin and Tobin to pay over the funds, but they each refused to do so, and that it would perpetrate a fraud upon the Surety Company and creditors of the contractor Tobin and would deprive them of payment for their labor and materials to permit Martin to retain the money which he had secured under the power of attorney, and would result in irreparable damage and injuries to plaintiff and creditors having claims for labor and material furnished under the contract in question (R. 10); that in view of the insolvency of the contractor, and the liability of the plaintiff Surety Company for the payment of the aforementioned claims for labor and materials, the Surety Company has in equity a lien upon the funds due from the Government under the facts of this case, including said final estimates collected by the said Guy S. Martin from the Government in connection with this particular job.

The prayer of the bill sought a permanent injunction against any additional collections from the Government by either Tobin or Martin; that Tobin and Martin be

perpetually enjoined from disposing of the moneys previously collected from the Government, particularly the $10,448.10, representing the final payment collected by Martin under the power of attorney; that Martin be ordered to deliver to the Clerk of the Court, or to a receiver, to be appointed by the Court, said sum of $10,448.10, representing the balance which Martin wrongfully received from the Treasurer of the United States, which amount was alleged to be then in his possession, and that when so deposited:

> "The said fund be impounded for the protection of plaintiff herein and all creditors who have outstanding unpaid claims for labor and material furnished in the construction of the Carlinville Post Office Building" (R. 14).

The bill also contained a prayer for "such other and further relief as the nature of the case may require and to the Court may seem meet and proper" (R. 15).

Defendants Tobin and Martin, being represented by the same counsel (who are appearing here as counsel for Martin), filed a joint and separate amended answer upon which the cause was tried (R. 18-25), which is sufficiently summarized in petitioner's brief herein.

Following the final hearing on the merits of the issues joined between plaintiff. National Surety Company and defendants Tobin and Martin, the trial court made and filed detailed written findings of fact and conclusions of law (R. 26-30). After Martin had paid the funds into the registry of the court in obedience to the decree, plaintiff petitioned the Court for an order fixing the time for the filing of claims (R. 32-33), and the order was duly made (R. 33), following which all of the respondents now before this Court (laborers and materialmen on the Carlinville

post office job) filed their respective claims to the funds in the registry of the court. Petitioner Martin likewise filed a claim (R. 34-38), in which he again asserted the same matters previously urged in his amended answer filed and heard the preceding year. A hearing on the claims was held October 18, 1934 (R. 130), following which the trial court again made and filed detailed findings of fact (R. 43-49).

At the time of the hearing on the claims counsel for plaintiff, National Surety Company (which had become insolvent and had been liquidated [R. 133]), in open court expressed a willingness to have respondents succeed to all of the Surety Company's rights in the impounded funds. Accordingly the situation at that time was that the contractor, Tobin, was insolvent; the surety on his bond, the National Surety Company, was insolvent and liquidated; the trial court had in its custody the impounded fund amounting to $10,448.10 and was confronted with the claims asserted thereto by the laborers and materialmen on the job from which the impounded funds arose and for whose benefit plaintiff expressly instituted the suit (R. 14), on the one hand, and on the other hand the contractor Tobin and the petitioner, Guy S. Martin, whose claim to the funds is based upon the facts hereinbefore set forth. The findings of the trial court with respect to petitioner Martin's claim to the impounded fund (R. 47-49) are accurately summarized in the opinion of the Court of Appeals (R. 157) and will not be repeated here.

## V.

## SUMMARY OF ARGUMENT.

### A.

Laborers and materialmen whose labors and property go into a federal public work are entitled in equity to a priority in payment out of funds which have become due to the contractor who has become wholly insolvent, where such funds remain in the hands of the Government after the completion of the job.

1. The Government has a moral obligation to see that laborers and materialmen on its public works are paid for their services.

2. Where a contract is executed under a statute requiring a bond conditioned upon prompt payment of laborers and materialmen, the requirements of the bond are impliedly a part of the contract and it is an implied obligation of the contract that the contractor will promptly pay laborers and materialmen as their claims mature, and his failure to do so is a default under the contract.

3. A general creditor of an insolvent contractor on a federal public work who has completed the building, but has defaulted in payment of laborers and materialmen, cannot defeat the equitable rights of such laborers and materialmen in the funds then remaining in the Government's hands by thereafter obtaining a power of attorney and collecting the funds from the Government where such general creditor had actual knowledge of all of the facts.

### B.

The surety on a contractor's bond executed in connection with a federal public work has an equitable lien

upon all funds which have become due and payable by the Government and remain in the Government's hands after the completion of the job or after a default by the contractor, where the contractor has become insolvent and has failed to pay accruing labor and material bills and where it is apparent from the contract, the statute and the agreement between the contractor and the surety in the application for the bond that the intention of the parties was to pay any obligation for which the surety might become liable under said bond out of the funds in question.

1. Where the principal has defaulted in his obligations for which the surety is liable, there arises without payment by the surety an equity of exoneration. The surety may proceed before payment quia timet, and equity will require to be applied to the obligation a fund which by the express or implied provisions of the contract of suretyship stands as a security for performance.

2. The statute making void all transfers of claims against the United States (31 U. S. C., Sec. 203) is solely for the protection of the United States against having to deal with a number of new parties in a transaction, and is not applicable to the assignment of funds accruing on a Government work executed by the contractor in favor of the surety on his bond as security for its obligations, where the requirements of the bond are specified by statute, the assignment operates in furtherance of the Government's moral obligation to see that those furnishing labor and materials on the job are paid, and no new parties are brought into the transaction by such assignment.

3. Even if the agreement between the contractor and his surety, contained in the application for the bond, be ineffective as an assignment in favor of the surety company, nevertheless, where all of the language of such application, considered together with

the main contract, the statute, and the bond, indicates an intention as between the parties that the funds accruing on the job will be used by the contractor to pay the claims of laborers and materialmen and thereby exonerate the surety of liability, a court of equity will impress a lien upon such funds in favor of the surety company, as between the parties and those having actual knowledge of the facts.

C.

The sole requisites of a partnership are that the parties must have joined together to carry on a trade or venture for their common benefit, each contributing either property, money or services and having a community of interest in the profits.

1. An established agreement to divide all net profits in specified proportions is presumptive evidence of a partnership and it is merely a question of fact whether, upon consideration of all of the other facts and circumstances, the presumption has been rebutted.

D.

An agent who has violated specific instructions of his principal and thereby placed his principal in a position where it is likely to suffer loss in a transaction, becomes liable to his principal as an indemnitor for any loss resulting from his wrongful act, and the agent cannot thereafter be heard to assert that he has acquired prior rights in funds arising in connection with such transaction, for which he remains an indemnitor of his principal even though the agency relationship has since terminated, but will be required to account to the principal for such money thereafter received by him in connection with such transaction.

E.

Where one who claims to have loaned money to a contractor obtains a power of attorney from the contractor under an express agreement to collect the money for the contractor and to first apply it to the payment of all unpaid labor and material bills on the job in connection with which the funds accrued, he will be required to account to the laborers and materialmen and the contractor's surety, who would otherwise be liable for the payment of such laborers and materialmen, as such funds will remain impressed with a trust in conformity with the agreement under which they were collected.

F.

The assignment of a chose in action made by an insolvent debtor with intent to defraud creditors, and with a reservation of right in favor of the debtor, is void, and the grantee acquires neither legal nor equitable rights thereunder.

G.

Where a general creditor of the contractor on a federal public work holds a void written assignment or power of attorney from the contractor, and by false statements and fraudulent concealment lulls the surety into a feeling of security, directly resulting in the surety delaying the taking of any action, such assignee upon thereafter collecting the funds from the Government, is estopped to assert that by so collecting such funds he has acquired any rights therein superior to the equitable rights of the surety and of the laborers and materialmen.

1. A power of attorney executed by a contractor on a federal public work in favor of a general creditor

covering funds to become due from the Government, is void. The subsequent collection of such funds by the holder of the power of attorney does not defeat equitable rights of the surety and of laborers and materialmen on the job with which such funds were impressed.

H.

A party must come into equity with clean hands.

## VI.

## ARGUMENT.

### A.

In the petition for writ of certiorari filed herein, petitioner suggests that the issue decided by the Court of Appeals and the question presented in this court is whether laborers and materialmen on a federal public work are entitled to an equitable lien on "progress payments" which have been collected by the contractor and paid to one who has loaned him money. Respondents insist that the issue is not so broad. **The question presented in this case is whether laborers and materialmen, whose labors and property went into the particular job, are entitled in equity to a priority in payment out of funds which have become due to the contractor, who has become wholly insolvent,** WHERE SUCH FUNDS REMAIN IN THE HANDS OF THE GOVERNMENT AFTER THE COMPLETION OF THE JOB; and whether a creditor of the insolvent contractor can defeat such equitable rights of the laborers and materialmen by obtaining a power of attorney and collecting the funds from the Government, after the job has been completed and after the contractor has become insolvent, where such creditor **then** had full and complete knowledge of all of the facts.

The courts have never hesitated to recognize the fact that the United States has a moral obligation to see that laborers and materialmen on federal public works are paid for their services. [See **Belknap Hdw. & Mfg. Co. v. Ohio River Contract Co. (C. C. A. 6), 271 F. 144,** reaffirmed on later app.; **Mesker et al. v. Ohio R. Sand Co. et al., 285 F. 379** (appeal dismissed, **264 U. S. 572, 68 L. Ed. 856**); **Henningsen v. U. S. F. & G. Co., 208 U. S. 404.**] The stat-

ute in force at the time in question, **U. S. C. A., Title 40, Sec. 270,** contains an express recognition of this obligation by providing that all contractors on federal public works shall furnish a bond conditioned upon the prompt payment of all labor and material bills. The statute requiring the bond is impliedly a part of the contract **[Glades County v. Detroit Fidelity & Surety Co. (C. C. A. 5), 57 Fed. (2) 449]**; and it is therefore an implied condition of the contract that the contractor will promptly pay the laborers and materialmen as their claims become payable and his failure to do so is a default under such contract. [See **Henningsen v. U. S. F. & G. Co., 143 F. 810,** affirmed **208 U. S. 404, 52 L. Ed. 547; Heyward v. Goldsmith (C. C. A. 3), 269 F. 946; Cox v. N. E. Equitable Insurance Co. (C. C. A. 8), 247 F. 955; First National Bank v. Fidelity & Deposit Co. (C. C. A. 10), 65 Fed. (2d) 959,** l. c. 962.]

We respectfully urge that no basis exists in logic or reason to conclude that by including laborers and materialmen within the benefits of the bond the Government has fully discharged its moral obligation to see that the laborers and materialmen are paid. The statutory recognition of the Government's moral obligation merely emphasizes its existence. It does not extinguish it.

In the case of **Henningsen et al. v. U. S. F. & G. Co. (C. C. A. 9), 143 Fed. 810** (affirmed on appeal to this Court, **208 U. S. 404, 28 Sup. Ct. 389, 52 L. Ed. 547**), an action was instituted upon facts and under circumstances essentially like the present action. In that case Henningsen and his partner contracted with the Government to construct certain buildings and the U. S. F. & G. Company executed the bond as surety, conditioned as in the instant case. After the buildings had been to a large extent completed, the contractor assigned the balance of the money coming to him under the contract for the purpose of

securing repayment of loans made to him by a bank during the progress of the work. The contract, in so far as concerned the completion of the buildings, was fully performed, but the contractors failed and refused to pay just and lawful claims of laborers and materialman amounting to about $15,000.00. Thereupon the surety company instituted a suit in equity for the purpose of establishing that both the surety and the unpaid laborers and materialmen on the job had an equitable lien on the funds remaining in the Government's hands (which do not appear to have been limited to the retained percentage), and to establish that the equitable rights of such unpaid laborers and materialmen were superior to any rights acquired by the money lender under an assignment. It is to be noted that the surety had not actually paid anything in that case, either at the time of the institution of the suit or at the time of the decree (143 F., l. c. 811), although it confessed its liability under its bond for unpaid labor and material claims, just as in the instant case the surety admitted its liability under its bond for the claims of unpaid laborers and materialmen (R. 9).

It appears from the briefs in the Henningsen case that the appellant pointed out that there had been no default by the contractor in the performance of his obligations to the Government inasmuch as the building had been completed; that the Government therefore had no further rights to be satisfied out of the funds remaining in its hands; and that no equitable lien existed in favor of the laborers and materialmen. The briefs filed by the surety company reflect that it based its position upon a right to be subrogated in equity to the prior rights of the laborers and materialmen who were creditors of the contractor.

In ruling the matter in favor of the surety company and against the assignee this Court stated:

"Is its equity superior to that of one who simply loaned money to the contractor, to be by him used as he saw fit, either in the performance of his building contract or in any other way? We think it is. It paid the laborers and materialmen, and thus released the contractor from his obligations to them, **and to the same extent released the Government from all equitable obligations to see that the laborers and supplymen were paid.** It did this not as a volunteer, but by reason of contract obligations entered into before the commencement of the work. • • •

"It is sufficient to say that we agree with the views of the Circuit Court of Appeals, expressed in its opinion in the present case:

> " 'Whatever equity, if any, the bank had to the fund in question, arose solely by reason of the loans it made to Henningsen. Henningsen's surety was, upon elementary principles, entitled to assert the equitable doctrine of subrogation, but it is equally clear that the bank was not, for it was a mere volunteer, and under no legal obligation to loan its money.' "

Judge Denison of the Sixth Circuit, in the case of **Belknap Hdw. & Mfg. Co. et al. v. Ohio River Contract Co. et al., 271 Fed. 144,** after reaffirming the Government's moral obligation to see that the claims of laborers and materialmen are paid, makes the following careful analysis of the basis of this Court's decision in the Henningsen case, supra, to wit:

"The surety's claim of priority in the fund was sustained, and this was done on the stated theory of subrogation. Since there cannot be the transfer of a right by subrogation, unless there is a right to be transferred, we think the necessary effect of the decision is to hold that the laborers and materialmen, in spite of or in addition to the giving of the bond, had

an original and continuing equitable priority in the fund, and that it was this right to which the surety was subrogated. This is not stated in the opinion in very express terms, but it had been pressed upon the Court (208 U. S. 407, 408, 28 Sup. Ct. 389, 52 L. Ed. 547) that there could be no such subrogation without such a right, and that there was no such right. On page 410 of 208 U. S., on page 391 of 28 Sup. Ct. (52 L. Ed. 547) the Court refers to and assumes that the Government, after the bond was given, was still charged with 'equitable obligations to see that the laborers and supply men were paid.' We are constrained to think that the decision necessarily rests upon the existence of this right, as one entitling these claimants to priority in payment out of the fund, and therefore as entitling the surety, as their equitable assignee by subrogation, to the same priority." • • •

"When Henningsen's surety paid up, the United States, the secured creditor, had been satisfied, and had no further claim on the fund, unless it bore the duty to devote the fund to the labor and material claimants; hence the latter proposition must be considered as affirmed."

The Court held that the laborers and materialmen on the job were entitled to an equitable lien on all of the funds which accrued on the job and were collected by a receiver appointed by the Court following the insolvency of the contractor and the insolvency of the surety, such funds totaling nearly $100,000.00 and being far in excess of the retained percentage.

The case of **Farmers Bank v. Hayes et al. (C. C. A. 6), 58 Fed. (2d) 34** (certiorari denied, **287 U. S. 602**), recognizes the existence of an equitable lien in favor of laborers and materialmen on a federal public work and expressly holds that the equitable rights of the laborers and materialmen extend not only to the reserved percentage un-

der the contract, but also to all other sums that have accrued under the contract. The opinion of Judge Simons states:

> "Upon the merits, the right of the surety to the fund here in dispute is settled by a long line of Federal and State cases * * * this is on the principle that a surety who gives bond to the owner to insure performance of a building contract by the contractor is subrogated to the rights of the owner in the percentage which the owner retains as security for the performance of the contract when upon default by the contractor the surety performs, as in the Prairie State National Bank case, or on the principle that when the contractor performs his obligation to the owner, but fails to pay labor and materialmen, and the surety is obligated to do so under his bond, the surety is subrogated to the liens of laborers and materialmen upon the fund reserved by the owner, as in the Henningsen case. * * * In either case the equitable rights of the surety become fixed as of the date of the bond and are superior to those of any holder of an after-acquired lien. Whether the lien of the surety extends only to the reserve percentage under the contract, or also to sums earned under the contract, and retained by the owner, is a question which has frequently been raised. We think it is now settled that it extends to both. Lacy v. Maryland Casualty Co., 32 F. (2d) 48; Exchange State Bank v. Federal Surety Co., 28 F. (2d) 485 (C. C. A. 8)."

In the Lacy case just mentioned Judge Parker, of the Circuit Court of Appeals for the Fourth Circuit, has carefully and accurately analyzed the authorities pertaining to the identical question now under consideration. The logic of his reasoning and the accurateness with which he has set forth the basis of the holdings of prior authorities leaves little to be added upon the subject. It would un-

necessarily lengthen this brief to undertake to quote that portion of the opinion which deals with this subject and which led him to the following conclusion:

> "The question arises whether this superior equity of the surety extends to the current estimates payable under the contract or merely to the retained percentage. We think that it extends to both" (32 F. [2d], l. c. 51).

In the case of **Exchange State Bank v. Federal Surety Co. (C. C. A. 8), 28 Fed. (2d) 485**, the Surety Company was forced to complete the job and pay labor and material claims. Thereafter there remained due under the contract about $31,000.00. The bank had loaned the contractor about $36,000.00 which was used largely in payment for labor and materials on the job and the bank took an assignment as security. Thereafter, suit was filed by the Surety Company against the bank over the right to the funds and in holding that an equitable lien in favor of the Surety Company "arose at the time of the execution of the bond and was superior to the assignment to the appellant bank," the Court did not limit such equitable lien to the retained percentages.

In the case of **U. S. Fid. & Guar. Co. v. Sweeney et al. (C. C. A. 8), 80 Fed. (2d) 235**, the Court expressly held:

> "Laborers and materialmen, however, have an equitable right to payment from funds due a contractor on a public improvement in preference to general creditors. Belknap Hardware & Mfg. Co. v. Ohio River Contract Co. (C. C. A. 6), 271 F. 144. The statutory requirement of a bond to protect them is not inconsistent with such equitable rights. American Surety Co. v. Westinghouse Elec. Mfg. Co. (C. C. A. 5), 75 F. (2d) 377. There is a recognized equitable right

of unpaid furnishers of labor or materials to such part of the contract price as may remain in the possession of the Government after the completion of the work by the contractor. Riverview State Bank v. Wentz (C. C. A. 8), 34 F. (2d) 419; Henningsen v. United States Fidelity & Guar. Co., 208 U. S. 404, 28 S. Ct. 389, 52 L. Ed. 547; Farmers Bank v. Hayes (C. C. A. 6), 58 F. (2d) 34; American Surety Co. v. Westinghouse Elec. Mfg. Co. (C. C. A. 5), 75 F. (2d) 377."

In the case of **In re P. M'Garry & Son (C. C. A. 7), 240 Fed. 400**, the contractor, M'Garry, had agreed to furnish all labor and materials for making certain improvements in the Post Hospital (a Government building) at Des Moines, Iowa, for the total contract price of $2,559.00. A bond was executed by the American Bonding Company, as required by the statute, conditioned as in the instant case. Thereafter the work was completed and accepted by the Government, whereupon there remained due and payable to the contractor the sum of $2,000.00, which was practically the entire contract price. The contractor had become bankrupt and the surety paid a portion of the claims of laborers and materialmen. Others had not been paid and the holder of an assignment from the Government collected from the Government the $2,000.00 that had accrued on the contract, just as was done in the instant case. The question arose in the bankruptcy court as to the respective rights of the unpaid laborers and materialmen, the surety company, the assignee of the contractor, and the contractor's general creditors with respect to the funds that had accrued on the job. In holding that the funds were subject to equitable rights in favor of the laborers and materialmen and in favor of the surety company, the Circuit Court of Appeals stated:

"The $2,000.00 fund in the hands of the trustee in bankruptcy stands charged with the same equities as to the materialmen and the surety upon the bond who had paid the materialmen, as it was bound to do, as when it was undistributed in the hands of the United States. Whatever rights were acquired by reason of the contractor's assignment and payment thereon by the United States, were subject to the right of the materialmen and surety on the bond to have their claims paid in full. • • •

"In the case at bar, the assignee of the contractor stands in the position of a mere volunteer and is not, therefore, entitled to the benefit of the doctrine of subrogation. Under the authorities quoted, the materialmen and the surety in the case at bar have a prior right to the extent of their claims in the fund so in the hands of the trustee, in the nature of an equitable lien. It precedes the rights of assignees of the contractor and also those of the general creditors."

A superior equitable lien or right in favor of laborers or materialmen in all funds remaining due from the Government either after the completion of the work or after a default by the contractor, was the basis of decision in each of the following cases:

**First National Bank of Seattle v. City Trust, Safe Deposit & Surety Co. (C. C. A. 9), 114 Fed. 529;**
**Philadelphia National Bank v. McKinlay (U. S. Ct. of Appeals for District of Columbia), 72 Fed. (2d) 89;**
**Moran v. Guardian Cas. Co., 76 Fed. (2d) 438;**
**London & Lancashire Indemnity Co. v. Endres et al. (C. C. A. 8), 290 Fed. 98;**
**Riverview State Bank v. Wentz et al. (C. C. A. 8), 34 Fed. (2d) 419; and**
**Maryland Casualty Co. v. Dulaney Lbr. Co. et al. (C. C. A. 5), 23 Fed. (2d) 378.**

The foregoing discussion has considered the question presented solely from the standpoint of the existence of an equitable lien in favor of laborers and materialmen upon funds remaining in the Government's hands after completion of the job. We now turn to the question of the equitable rights acquired by the Surety Company in those funds arising in connection with its suretyship obligations at the inception of the contract.

B.

**The Surety on a Contractor's Bond Executed in Connnection With a Federal Public Work Has an Equitable Lien Upon All Funds Which Have Become Due and Payable by the Government and Remain in the Government's Hands After the Completion of the Job or After a Default by the Contractor, Where the Contractor Has Become Insolvent and Has Failed to Pay Accruing Labor and Material Bills and Where It Is Apparent from the Contract, the Statute, and the Agreement Between the Contractor and the Surety in the Application for the Bond, That the Intention of the Parties Was to Pay Any Obligation for Which the Surety Might Become Liable Under Said Bond Out of the Funds in Question.**

In the Surety Company's amended bill, upon which this case was tried (R. 6-15), it is expressly stated that the suit was instituted for the benefit of "all creditors who have outstanding unpaid claims for labor and material furnished in the construction of the Carlinville Post Office Building" (R. 14). However, in addition to that plaintiff pleaded the insolvency of the contractor, his default in the payment of accrued labor and material bills, and after admitting its own liability under the bond for such bills,

plaintiff pleaded its right in equity to be exonerated out of the funds which had accrued on the job and remained in the Government's hands after the completion of the work on February 1st (R. 79). Plaintiff also pleaded that when the funds were thereafter collected on February 6th by the assignee, Martin (R. 96), such funds remained impressed with the equities that had then accrued in favor of the Surety Company, with respect to which Martin had actual, as well as constructive, notice. (Plaintiff also alleged that the power of attorney in favor of Martin was a fraudulent conveyance, a matter that will be hereafter treated separately.) In this connection it is to be recalled that the contract with the Government, in addition to requiring the statutory bond guaranteeing the prompt payment of all claims for labor and materials, contained this provision:

> "(d) Upon completion and acceptance of all work required hereunder, the amount due the contractor under this contract will be paid upon the presentation of a properly executed and duly certified voucher therefor, **after the contractor shall have furnished the Government with a release, if required, of all claims against the Government arising under and by virtue of this contract**, other than such claims, if any, as may be specifically excepted by the contractor from the operation of the release in stated amounts to be set forth therein" (R. 88).

The bond, which is required by statute as a part of the contractor's obligation to the Government and which is executed by the contractor as principal, expressly binds and obligates the contractor to "**promptly make payment to all persons supplying the principal with labor and materials in the prosecution of the work provided for in said contract**" (R. 92); and in conjunction with said bond,

which was executed by petitioner Martin as agent for the National Surety Company, the contractor was required to sign an application to the Surety Company which bound and obligated the contractor to indemnify and keep indemnified the Surety Company and to hold it harmless against all liability, loss and expenses which the Surety Company shall at any time sustain or incur under the bond (R. 89). The contractor further agreed in the application as follows:

> "Sixth. That in further consideration of the execution of said bond, the undersigned hereby assigns, transfers and conveys to the Company all the deferred payments and retained percentages, and any and all moneys and properties that may be due and payable to the undersigned at the time of any breach or default in said contract, or that thereafter may become due and payable to the undersigned on account of said contract, or on account of extra work or materials supplied in connection therewith, hereby agreeing that such money, and the proceeds of such payments and properties shall be the sole property of the Company and to be by it credited upon any loss, cost, damage, charge and expense sustained or incurred by it under said bond" (R. 91).

The application contained this further highly important provision:

> "that the applicant had not assigned and **would not assign** his payment on this contract or any part thereof" (R. 89).

Having in mind the foregoing facts in connection with the execution of the bond by the Surety Company, respondents respectfully urge the proposition that when a contractor on a public work not only defaults in payment

of accrued labor and material bills, but has also become insolvent, his surety then becomes entitled in equity to have all of the unpaid funds which remain in the hands of the Government at that time applied in exoneration of its liability under the bond. We know of no clearer statement of the proposition than the following excerpt from the case of **Glades County v. Detroit Fidelity & Surety Co. (C. C. A. 5), 57 Fed. (2d) 449**, to wit:

> "As between the surety and the principal there arises without payment by the surety and without his having even been sued an equity of exoneration. Story, Eq. Juris. (14 Ed.), Sec. 1011; Pomeroy, Eq. Rem., Sec. 919; Stearns on Suretyship, Sec. 281; Pavarini v. Title Guaranty Co., 36 App. D. C. 348; Ann. Cas. 1912 C 367 and note. To have subrogation a surety must have discharged in full the obligation for which he is bound, and he then seeks to recover for himself the subject of the suit. In case of exoneration he proceeds before payment quia timet, and seeks to have payment made to the creditor. If the principal is solvent, the decree need not go further than to require the principal to pay, but, when he is fraudulent, insolvent, or has absconded, the equity of exoneration needs and may have further protection. Injunctions, receivers, and equitable garnishments have been granted, property recovered from third parties, and funds traced and applied. West v. Chasten, 12 Fla. 315; Hayden v. Thrasher, 18 Fla. 795; Bunting v. Ricks, 2 Dev. & B. Eq. (22 N. C. 130, 32 Am. Dec. 699); Sanford v. U. S. F. & G. Co., 116 Ga. 689, 43 S. E. 61; Cooper v. National Fert. Co., 132 Ga. 529, 64 S. E. 650. Assuredly equity will require to be applied to the obligation a fund which by the very contract of suretyship stands as a security for performance. In Story Eq. Jur., Sec. 1011, after stating the jurisdiction to protect the surety quia timet, there is added: 'And generally it may be

stated that in case of contracts, express or implied, courts of equity will interpose to preserve the funds devoted to particular objects under such contracts and will decree what is in effect specific performance, security to be given, or the fund will be placed under control of the court.' "

While in that case the fund that happened to remain in the hands of the Government was the retained percentage, there is no basis in reason for so limiting the application of the rule, in view of the provisions which we have quoted above from the contract, the bond and the application for the bond, which are involved in the instant case. One cannot read those voluntarily assumed contractual obligations undertaken by the contractor Tobin and by the petitioner Martin, who was then acting for the Surety Company, without coming to the conclusion that as between the parties an obligation arose, enforceable in a court of equity, to apply all funds accruing on this job to the exoneration of the surety's liability. If the surety had such equitable right from the inception of the contract, the right became certain and fixed when upon the completion of the job the contractor had become insolvent and had defaulted in payment of labor and material bills, and the funds in question then remained in the Government's hands. Petitioner Martin, with knowledge of all of these facts and with knowledge of the contractor's insolvency, could not defeat the rights that had been acquired by the Surety Company by thereafter collecting the funds. See:

**Cox v. New England Equitable Ins. Co. (C. C. A. 8), 247 Fed. 955;**
**U. S. F. & G. Co. v. Bank of Brenton, 4 F. S. 272;**
**In re P. M'Garry & Son, 240 Fed. 400;**
**U. S. F. & G. Co. v. Sweeney et al., 80 Fed. (2d) 235;**

**First National Bank v. City Trust Safe Deposit & Surety Co., 114 Fed. 529;**
**Moran v. Guardian Cas. Co., 76 Fed. (2d) 438.**

The Circuit Court of Appeals in the instant case held that that clause in the application for the bond by which the contractor Tobin assigned to the Surety Company not merely the reserved percentages, but all funds becoming due and payable on the contract, by way of security for the Surety Company's obligations, was void under the provisions of 31 U. S. C., Sec. 203 and cases construing said statute, such as **Spofford v. Kirk, 97 U. S. 484.** Respondents feel that inasmuch as the surety's obligations were required by the provisions of the statute (40 U. S. C., Sec. 270) and no new parties are brought into the situation as a result of the assignment made by the contractor to the surety, the Circuit Court of Appeals gave too narrow a construction to the statute prohibiting assignments and lost sight of the objects sought to be accomplished by its enactment. We respectfully urge that this Court should permit the assignment contained in the application for the bond to be fully sustained under the authority of the following cases:

**Goodman v. Niblack (12 Otto), 102 U. S. 556, 26 L. Ed. 229;**
**Price v. Forrest, 173 U. S. 410, 43 L. Ed. 749;**
**McGowan v. Parrish, 237 U. S. 285, 59 L. Ed. 955;**
**Lay v. Lay, 248 U. S. 24;**
**Wardman v. Leopold, 85 Fed. (2d) 277, l. c. 281.**

The Government's moral obligation to see that laborers and materialmen are paid on a public work is an additional reason for relaxing the strict letter of the statute prohibiting assignments, as was done in the Goodman case, supra (involving a voluntary assignment for the benefit of

creditors), and justifies the application of the rule of law that where the reason for the statute has failed the statute itself has no application.

But irrespective of the effectiveness of the assignment in favor of the Surety Company to operate as an "assignment," respondents respectfully urge that this Court is nevertheless entitled to consider all of the language contained in the application for the bond, including that relating to the assignment of payments accruing on the job, **for the purpose of determining whether the parties have (as between themselves and those having actual knowledge of the facts, as Martin did) indicated an intention to pay any obligation for which the surety may become liable under the bond out of the funds in question**, to an extent sufficient to impress those funds with an equitable lien in favor of the surety as between the parties and those having actual knowledge.

We quote the following pertinent language from Judge Booth's opinion in the case of **Exchange State Bank v. Federal Surety Co. (C. C. A. 8), 28 Fed. (2d) 485**, to wit:

> "We think the first contention of appellant rests upon a misconception of the nature of an equitable lien, as well as of the real status of the assignment agreement contained in the application for the bond. An equitable lien may arise ex aequo et bono, or it may arise out of an express contract. 37 C. J. 315, 319; Pomeroy, Eq. Juris. (3d Ed.), Sections 1239, 1235; Bishpam on Equity, Par. 351; Walker v. Brown, 165 U. S. 654, 17 S. Ct. 453, 41 L. Ed. 865. And we see nothing in the nature of an equitable lien which would prevent it from having its origin in both sources. In such cases the express contract would serve to make definite and certain some elements which otherwise would have to be ascertained from surrounding facts and circumstances.

"Such, we think, is the proper construction to be placed upon the assignment agreement in the bond application in the case at bar. That the equitable lien may be enforced, though an assignment agreement exists, has been held in numerous cases. American Surety Co. v. Finletter (C. C. A.), 274 F. 152; U. S. F. & G. Co. v. City of Bristow (D. C.), 4 F. (2d) 810; Ottumwa Boiler Works v. O'Meara (Iowa), 218 N. W. 920; City of Detroit v. Fidelity & Deposit Co., 240 Mich. 213, 215 N. W. 394. We have not been cited to any case holding the contrary. It may, indeed, be doubted whether such assignment agreements in surety bond applications can be given any force, except the limited one above indicated. See Jenkins v. National Surety Co., 277 U. S. 258, 48 S. Ct. 445, 72 L. Ed. 874, opinion filed May 14, 1928. We think that the trial court, in the case at bar, properly held that the Surety Company had an equitable lien.

"That the equitable lien thus recognized arose at the time of the execution of the bond and was superior to the assignment to the appellant bank is decided by the great weight of authority."

The case of **Geddes v. Reeves Coal & Dock Co., 20 Fed. (2d) 48**, asserts the proposition that a contract under which one party is to receive compensation for services out of a particular fund, if and when realized, and which has been performed by such party, gives him an equitable lien on the fund when created in the hands of any one having notice of the contract; and in so holding the Court states:

"But, upon consideration, like the Circuit Court of Appeals of the Third Circuit in American Surety Co. v. Finletter, 274 F. 152, 156, and Judge Kennamer, in U. S. Fidelity & Guaranty Co. v. City of Bristow (D. C.), 4 F. (2d) 810, 'we are inclined rather to the views of the same court (the Supreme Court) ex-

pressed in **Ingersoll v. Coram**, 211 U. S. 335, 29 S. Ct. 92, 53 L. Ed. 208, accepting the rule stated in **Walker v. Brown**, 165 U. S. 654, 17 S. Ct. 453, 41 L. Ed. 865, to the effect that **an express executory contract in writing, whereby the contracting parties sufficiently indicate an intention to make some particular property or fund, therein described or identified, a security for a debt or other obligation, creates an equitable lien on the property so indicated.'** "

In the case of **Sexton v. Kessler & Co., 225 U. S. 90**, Mr. Justice Holmes, speaking for this Court, said:

"While the phrase 'equitable lien' may not carry the reasoning further or do much more than express the opinion of the Court that the facts give a priority to the party said to have it, we are of opinion that the agreement created such a lien, at least; or, in other words, that **there is no rule of local or general law that takes from the transaction the effect it was intended to produce. Hurley v. A. T. & S. F. Ry. Co., 213 U. S. 125,** * * *."

Accord:

**Ingersoll v. Coram, 211 U. S. 335, l. c. 367-8.**

In addition to the clause in the contractor's application for the bond, whereby the future payments were assigned to the Surety Company as security for its obligations, **said application contained an express agreement on the part of the contractor that he would not thereafter transfer any part of those funds to any one** (R. 89). In the case of **Central State Bank v. U. S. F. & G. Co. (C. C. A. 5), 9 Fed. (2d) 326,** Certiorari denied **270 U. S. 656**, where an entirely analogous clause was under consideration, the Court stated:

"The bank took its assignment with full notice of

the clause of the contract which provided that no assignment should be binding without the written consent, not only of the school board, but of the surety, also. That clause, in and of itself, is, in our opinion, sufficient to establish the superiority of the surety's claim over that of the bank. Prairie State Bank v. United States, 164 U. S. 227, 17 S. Ct. 142, 41 L. Ed. 412; Henningsen v. U. S. Fidelity & Guaranty Co., 208 U. S. 404, 28 S. Ct. 389, 52 L. Ed. 547. It provides against assignment without the surety's consent, not only of the contract itself, but of any interest therein, which, of course, included the reserve fund which is the subject of this controversy."

The cases of **U. S. F. & G. Co. v. City of Bristow et al. (D. C.), 4 Fed. (2d) 810**, and **Hartford Accident & Indemnity Co. v. Coggin, 78 Fed. (2d) 471, l. c. 477-8**, expressly recognized that language in an application for a bond virtually identical with the provisions contained in the application for the bond in the instant case, give rise to an equitable lien in favor of the Surety Company. While in several of the cases to which we have referred it happened that the retained percentage was all that was involved, yet the controlling principles of law which led the courts to hold that an equitable lien existed, are not thus limited, and are applicable here, in view of the broad language contained in the application for the bond involved in the instant case, clearly indicating the parties' intentions.

We desire to particularly direct the Court's attention to the case of **Philadelphia National Bank et al. v. McKinley et al., 72 Fed. (2d) 89**, certiorari denied **293 U. S. 583**. In that case the contractor on a federal public work partially completed the job, incurring various labor and material bills, and defaulted. Thereupon the Surety Company completed the job, incurring additional labor and material

bills. About the time it completed the job the surety became insolvent and there remained in the Government's hands $68,244.86. Various laborers and materialmen, some of whom furnished labor and materials to the original contractor, and some of whom furnished labor and materials to the Surety Company, filed suit against the Government, the contractor's trustee in bankruptcy and the Surety Company to establish their equitable lien upon all of the funds so remaining in the Government's hands. In sustaining their claim of lien the Court stated:

> "In the view we take of this case, that sum is earmarked with the claims of all persons furnishing supplies and labor on the contract, and this is true because, irrespective of the statutory bond, those persons who furnish labor and do work on a Government project have an equitable lien on the fund, for the payment of their work and labor, until the fund is paid to the contractor. Belknap Mfg. Co. v. Ohio R. Co. (C. C. A.), 271 Fed. 144." • • •
>
> "The obligation of the surety was to pay these debts. If this obligation had been discharged, the fund now in the hands of the government would belong to it, but since it was not complied with, **and since the surety is, by reason of insolvency, unable to comply, it is a fair conclusion, we think, that irrespective of the question whether the laborers and supply men had equitable liens on the fund, at least, in the circumstances we have named, they should be considered by a court of equity as subrogated to all the rights of the surety,** who admittedly had such a lien."

Respondents urge that an entirely analogous situation is presented here, in view of the contractor's insolvency and of the Surety Company's insolvency. The rules announced in the case last cited are those which a court of equity should apply to the situation presented here.

The equitable rights of a surety company, in a case involving merely the retained percentage, was recognized by this Court in **Prairie State National Bank v. U. S., 164 U. S. 227.** That the controlling principles forming the basis for this Court's decision in that case are equally applicable to all funds remaining in the Government's hands after the completion of the job, and the insolvency of the contractor, is distinctly recognized and pointed out in the cases of **First National Bank v. City Trust, Safe Deposit Co. (C. C. A. 9), 114 Fed. 529,** and **Lacy v. Maryland Casualty Co. (C. C. A. 4), 32 Fed. (2d) 48** In the latter case Judge Parker stated:

> "The leading case on the rights of the surety is Prairie State Bank v. U. S., supra, in which the opinion was written by Mr. Justice White. Although that case dealt with rights in a retained percentage, the principles upon which the decision was based support as well the right of the surety to unpaid current estimates. The Court there said:
>
> "'Hitchcock's right of subrogation, when it became capable of enforcement, was a right to resort to the securities and remedies which the creditor (the United States) was capable of asserting against its debtor Sundberg & Company, had the security not satisfied the obligation of the contractors, and one of such remedies was the right based upon the original contract to appropriate the ten per cent retained in its hands. If the United States had been compelled to complete the work, its right to forfeit the ten per cent and apply the accumulations in reduction of the damage sustained remained. The right of Hitchcock to subrogation, therefore, would clearly entitle him when, as surety, he fulfilled the obligation of Sundberg & Company, to the Government, to be substituted to the rights which the United States might have asserted against the fund."

In the First National Bank case, supra, Judge Gilbert stated:

> "By abandoning the contract the contractors lost the right to compel the city to pay them any sum whatever on account of the work which they had done. Their assignee, the bank, stood in no better position than they. The city undoubtedly had the right to declare the contract and all unpaid sums which it had promised to pay thereunder forfeited. **That it had this right is not disputed, but it is said that the city has not exercised it, and that, therefore, the right cannot avail the surety. But the true inquiry is, not what has the city done, but what had it the right to do?** It had the right, if it had itself assumed the completion of the abandoned work, to retain for its own protection not only the stipulated 30 per cent, but all sums then due or earned under the contract, and no assignment by the contractors could defeat that right."

Accord: Moran v. Guardian Cas. Co., 76 Fed. (2d) 438, wherein it is also pointed out that the fact that the moneys borrowed by the contractor from the holder of the assignment were used in the payment of labor and material bills did not give the assignee any additional rights nor in any way defeat the Surety Company's prior equitable rights.

**In Conclusion,** it should be remembered that in the instant case the Surety Company had already tried out the issues as between itself and the assignee, Martin (R. 118, 26, 30), and the funds in question had been paid into the registry of the District Court (R. 31, 32) prior to the time that the Surety Company became insolvent and was liquidated (R. 133). It was nearly a year later that the Court made an order directing claimants to the funds to file their

claims (R. 33-34) and at the final hearing on the claims counsel for the Surety Company confessed and admitted the right of the laborers and materialmen to succeed to all of the Surety Company's rights in this case (R. 133-4). This was in conformity with the allegations of the amended bill praying that the funds be brought into the registry of the court for the benefit of the laborers and materialmen on the job (R. 14). Respondents, therefore, urge that they are in a position to claim the benefits of all rights and equities of the Surety Company, as well as all rights and equities to which they themselves are entitled, in the funds in question. Any result other than the one reached by the District Court and the Circuit Court of Appeals in the situation presented here would give rise to a situation by which contractors of uncertain financial standing and integrity could procure financing through money lenders on a "division of profits" basis, and leave the United States Government in the position of having established a policy of acquiring title to public buildings and improvements without assuming any obligation, legal or moral, of paying those whose labor and materials went to create the building or improvement in question, whether the furnishers of such labor and materials be the materialmen, as in this case, or the Surety Company, after a default by the contractor. Money lenders are mere volunteers that the Government has no moral duty to protect. In addition, as a matter of public policy, it would be better to establish rules of law which would result in solvent contractors bidding on Government projects and discourage those who would have to make arrangements for finances by borrowing the money for the project. Upon considerations of precedent and authority, upon considerations of reason and of logic, and upon considerations of the questions of policy involved, respondents earnestly urge that

the rulings of the courts below in the instant case should be in all respects affirmed. In the event this Court agrees with our views concerning the matters that have been discussed, it will not be necessary to consider the additional points hereinafter set forth, as the Court of Appeals did not pass upon these points. However, if this Court, for some reason not now apparent to respondents, should adopt a view contrary to that adopted by the trial court and the Circuit Court of Appeals with respect to the foregoing points, we assume that it will nevertheless consider the additional points hereinafter set forth, each of which points out a conclusive reason why the petitioner, Martin, is not entitled to the funds in question, but respondents are.

C.

**The Sole Requisites of a Partnership Are That the Parties Must Have Joined Together to Carry on a Trade or Venture for Their Common Benefit, Each Contributing Either Property, Money or Services and Having a Community of Interest in the Profits.**

From a consideration of all of the facts in the record and from the Court's personal observation of the witnesses the District Court found as a fact that petitioner Martin "was a partner of A. Clement Tobin in connection with the Carlinville post office," and could not therefore assert claims superior to the claims of the laborers and materialmen who became creditors of that venture (R. 47). As stated in petitioner's brief herein, the Court of Appeals did not find it necessary to rule upon any point except that which we have already discussed. However, petitioner is mistaken in stating that the only evidence of partnership is the testimony of the contractor relative to his agreement with Martin to divide profits on the job and in concluding

that the relationship was therefore merely that of borrower and lender within the rule of **Meehan v. Valentine, 145 U. S. 611,** as will be presently pointed out.

The case of **Meehan v. Valentine, 145 U. S. 611,** appears to us to have been correctly decided and to correctly announce as many general rules as a court could safely announce concerning so uncertain a subject as the law of partnerships. In that case the Court was construing a written agreement, nothing more. That agreement expressly stated that the sole arrangement existing between the parties was the loan, and further negatived the idea of any **existing** partnership by use of the following language in a renewal of said obligation:

> "**We have two propositions for partnerships May 1st,** and if we accept either we will then, if you desire, return your loan."

The Court held that the mere fact that the agreement provided that the defendant should be paid one-tenth of the net profits over the sum of $10,000.00 per annum, in addition to interest on the money loaned, as the expressed consideration **for the loan,** did not make the lender liable for all of the firm's obligations as a partner. At the outset of the opinion Mr. Justice Gray expressly approves **Ward v. Thompson, 63 U. S. 330,** and states:

> "The requisites of a partnership are that the parties must have joined together to carry on a trade or adventure for their common benefit, each contributing property or services, and having a community of interest in the profits."

After tracing many authorities reflecting the development of the law of partnerships, this Court, in the Meehan case, concluded:

"In the present state of the law upon this subject, it may perhaps be doubted whether any more precise general rule can be laid down than, as indicated at the beginning of this opinion, that **those persons are partners who contribute either property or money to carry on a joint business for their common benefit, and who own and share the profits thereof in certain proportions.** If they do this, the incidents or consequences follow that the acts of one in conducting the partnership business are the acts of all; that each is agent for the firm and for the other partners; that each receives part of the profits as profits, and takes part of the fund to which the creditors of the partnership have a right to look for the payment of their debts; that all are liable as partners upon contracts made by any of them with third persons within the scope of the partnership business; that even an express stipulation between them that one shall not be so liable, though good between themselves, is ineffectual as against third persons. **And participating in profits is presumptive, but not conclusive, evidence of partnership.**"

Mr. Pollock's definition is most suggestive **(Pollack, Partnership, 11th Edition, page 4)**:

"Partnership is the relation which subsists between persons who have agreed to share the profits of a business carried on by all or any of them on behalf of all of them."

In the case of **Ward v. Thompson, 63 U. S. 330**, it was held that where the parties have joined together to carry on a certain venture (the operation of a steamboat between designated points) for their mutual profit, one contributing the vessel, the other his labor and services, and there

is a community of profits on a fixed ratio, it is a partnership. Accord:

**Beauregard v. Case etc., 91 U. S. 134;**
**Campbell v. Northwest Eckington Improvement Co. et al., 229 U. S. 561.**

In the latter case it is held that an agreement between the owners of unimproved property and a builder and manager of real estate developments, whereby, in consideration of his undertaking to give his services and financial assistance in improving and marketing the property, he is to become possessed of an undivided one-third interest in said property, created a partnership with respect to the venture.

In the case of **Manson v. Williams (C. C. A. 1st), 153 Fed. 525**, Judge Putnam states:

> "The right to share profits is an indication of the existence of a copartnership, but it may result from an agreement to that effect or it may flow out of the relationship which exists between the parties. It is true that the present case is embarrassed by the fact that, in the absence of any agreement as to the profits, in connection with the further fact that Henry Hudson contributed only assets, while James Hudson contributed only personal services, it may be difficult to determine how profits would have been shared, and therefore it is plausible to suggest that there could have been no profits, and consequently no partnership. Nevertheless, both of these details are met by **Paul v. Cullum, 132 U. S. 539**, where it was observed that, in the absence of any evidence showing a definite intention, partners would be held to share equally in the profits and losses."
>
> "The result is that whatever may have been the intention when Henry Hudson put the property into the

hands of James Hudson to be managed by him, those gentlemen and the circumstances of the business drifted entirely away from it, and the relations between them must be determined by what afterwards ensued. Those relations embraced all of the elements necessarily included in the definitions given by the Partnership Act (referring to the English Act) and by Mr. Justice Gray (referring to Meehan v. Valentine, supra) * * *."

In the case of **Re John E. Enright (C. C. A. 2d), 40 Fed. (2d) 588**, Judge Chase states:

"It is thought by the claimant that these libels in rem will not lie against the tug, however, because it is claimed that the Independent Towing Company and the barge owners had by their agreement entered into a partnership into which the tugs and barges had been put as partnership property. We think their agreement did create a partnership. They voluntarily joined in the business of general transportation of merchandise on the canal between New York and Buffalo. The principal contribution of one party was the motive power and that of the others the carrying capacity. All were to own an agreed interest in the net profits as such after expenses were paid. All the essential earmarks of a partnership were embodied in this agreement. **Meehan v. Valentine, 145 U. S. 611, 12 S. Ct. 972, 36 L. Ed. 835; Ward v. Thompson, 22 How. 330, 16 L. Ed. 249.**"

Before turning to a consideration of the evidence of partnership in the record in the instant case we direct the Court's attention to the further rule of partnership law, quoted approvingly in **Meehan v. Valentine**, supra: a showing of participation in profits constitutes prima facie or presumptive proof of the existence of the partnership

relation. As held by the Court in **Huteson v. U. S. (C. C. A. 7th), 67 Fed. (2d) 731,** proof of participation in profits constitutes presumptive evidence of partnership, and thereupon it became the duty of the Court to consider such evidence of partnership, together with all other material evidence in the case in determining the true status of the parties. "It certainly cannot be denied that the presumption arising from appellant's extensive participation in the profits, constitutes substantial evidence of his partnership in the business. Whether this presumption was outweighed by other evidence was a matter of fact to be determined by the trial court, and with that we are not concerned."

In the instant case the record affirmatively reflects: "Tobin testified in answer to the question of whether he had a silent partner on the Carlinville job that there was an arrangement between himself and Guy S. Martin that if he (Tobin) was short of money he was to draw on Martin and Martin was to help him out from time to time, and if at the conclusion of the job there was a profit, that they were to split the profit" (R. 137). He further testified: "While there was nothing in writing, it was agreed that if I needed funds at any time I could get a lift from Mr. Martin. In return for that, at the completion of the various jobs, the profits were to be divided on a fifty-fifty basis. That arrangement commenced on the Havana job and carried right on through the Carlinville job" (R. 138).

Tobin further testified that the arrangement was that at the conclusion of the job Martin was to be repaid the moneys he had advanced (in addition to his half of the profits), but that **he was not to be repaid until after Tobin had first paid all of his laborers and materialmen** (R. 141). See also Exceptor's Exhibit 2, being a letter written by Martin to Tobin on January 11, 1932, as follows:

"Dear Clem:

Your brother called the other day to tell me that you are the low bidder on the Carlinville Post Office, which was somewhat of a surprise to me. There must be a mistake somewhere as I thought you had your bid made out at $55,000.00. However, if you acquired any information which would warrant you in reducing it and know that it is all right, it is o. k. with me, provided we can satisfy the surety company.

Mr. J. W. Gerhardt, a friend of mine from Cape Girardeau would like very much to meet you in St. Louis, and if you will advise me when you expect to be here, I will arrange to have him meet with all of his dope on the Cape Girardeau Post Office" (R. 139-140)."

While on cross-examination Tobin testified that the letter referred to the matter of Martin obtaining a bond for Tobin on this contract, nevertheless it is significant that Martin wrote "it is o. k. with me, provided we can satisfy the surety company." It is apparent that, in addition to the question of satisfying the Surety Company, Martin felt called upon to give his personal approval to the matter of the reduction in the bid. It is a fair inference from Martin's later conduct in executing the bond contrary to express instructions of the vice-president of the National Surety Company (R. 80) that Martin was not concerned about the Surety Company when he wrote the above-mentioned letter, but was concerned only because of his personal interest in the venture.

The record further reflects that, toward the conclusion of the Carlinville post office job, December, 1922, and January, 1933, Martin affirmatively denied that Tobin was indebted to him for any amount (R. 82, 83, 86, 87). At the time Martin made these statements to various representa-

tives of the National Surety Company, it cannot be suggested that they were made because of his connection with the National Surety Company, because that connection had long since been terminated (R. 80). Such denials of indebtedness from the contractor coming from Martin's own lips are strong evidence that Martin considered the moneys advanced by him to be a contribution to capital in an enterprise in which he was then engaged (with Tobin) and not a mere loan as he later claimed.

Another equally cogent circumstance is that Martin himself testified under oath at the last hearing in this case:

> "I don't believe that we agreed upon any rate of interest in connection with the Tobin jobs for which I was furnishing money" (R. 143).

Yet Martin doesn't contend that he was to be compensated for the loan by a division of the profits in lieu of an agreed interest rate. He denies having had any agreement to share in the profits (R. 143). His admission that no interest rate was agreed upon negatives the idea of a loan and his unwillingness to admit having any agreement to share in the profits evidences a "guilty conscience" with respect to his real relationship to this job.

It is undisputed that Martin made arrangements whereby Tobin could draw checks directly against Martin's account (R. 96, 106). Another significant circumstance in connection with the moneys advanced by Martin is that he continued to furnish money to Tobin through the month of January and through the month of February of 1933 (R. 124-125), although in the first week of January, 1933, the branch manager of the National Surety Company checked about $9,000.00 of unpaid bills with Martin (R. 82), and on December 21, 1932, when Martin procured the power

of attorney from Tobin, he was advised by Tobin that there were going to be some bills to pay (R. 99), and, even before Martin received the power of attorney, Mr. Hauck, adjuster for the National Surety Company, told him that there were outstanding bills amounting to $9,500.00 (R. 101). It is equally significant that in January, 1933, after being advised that there were unpaid bills amounting to $9,000.00, Martin professed to believe that there was sufficient money in the contract to insure its completion and pay all bills (R. 82), although the then unpaid balance due from the Government totaled only $16,148.10 (being the $10,448.10 subsequently collected by Martin [R. 100], plus the $5,700.00 then remaining in the Government's hands [R. 79]), whereas, according to the claim he subsequently filed, there was due him as of January 6, 1933, the sum of $9,529.90 on the Carlinville post office job alone (R. 127). In spite of his knowledge of the amount of the unpaid bills, as pointed out, Martin expressed a willingness to have all labor and materialmen paid (R. 99, 101, 81).

Even after going to Washington and collecting the money under the power of attorney given to him by Tobin, Martin agreed to pay the unpaid laborers and materialmen (R. 87, 81, 100, 114); although adjuster Hauck advised him in December, 1932, that the outstanding bills amounted to $9,500.00 (R. 101), Mr. Edgar, local manager of the Surety Company, checked over $9,000.00 of unpaid bills with Martin during the first week in January, 1933, and in the office of the attorney for the National Surety Company on February 15, 1933, Martin saw bills which aggregated $13,000.00 (R. 100). There is nothing about Martin's conduct in connection with this entire transaction to cause one to conclude that his motives were merely altruistic when he expressed a willingness and a desire to see the bills of the laborers and materialmen paid. The more

reasonable conclusion is that his conduct reflected an admission of his own liability in the matter.

Martin not only advanced money on the Havana post office job on which Tobin was also the contractor, but he made arrangements with the surety on the job to collect the funds remaining due from the Government when Tobin defaulted in the payment of his bills on that job (R. 103, 104, 117-118, 97). Inasmuch as the job was completed in October of 1932 (R. 103), we are impelled to conclude that Martin had full and complete knowledge of Tobin's insolvency and inability to meet his debts as early as October, 1932. After binding himself to act as trustee for the Maryland Casualty Company, who was surety on the Havana post office job, Martin, in an effort to support his claim in the instant case, testified that he diverted such trust funds coming into his hands from the Havana job and applied them and permitted their use by Tobin on their joint enterprise in the Carlinville post office job and thereby left unpaid some $5,258.00 of labor and material bills on the Havana post office job (R. 98, 101, 104). Surely nothing less than a pecuniary interest in the Carlinville job could have caused Martin to so violate his trust on the other job, resulting in Martin being thereafter sued by the Maryland Casualty Company in connection with the matter (R. 141-142).

The next circumstance indicating the existence of the partnership relation between Tobin and Martin is that Martin's own secretary, offered as a witness in his behalf, testified to a custom of people having claims against Tobin calling Martin concerning the accounts, and of Martin then ordering the secretary to enter such items as a charge on his books. The secretary testified: "I would hear these people calling up about their accounts, and when he told me to enter them I just put them in * * *. We did not

pay out these items, but Mr. Martin guaranteed to pay them" (R. 103).

Although admitting that there was no agreement covering the matter of interest as has been pointed out, the records Martin offered at the trial reflected an arbitrary entry of a charge against Tobin of $1,000.00 which Martin calls "an arbitrary charge for interest" (R. 95) and concerning which Martin testified "at that time Mr. Tobin represented to me that he had considerable profit in both jobs, and I figured that would be fair" (R. 98). The matter of entering $1,000.00 charges against Tobin was not an unusual one according to Martin's secretary who testified: "**When Mr. Martin would tell me to charge up $1,000.00** I would put it in the ledger. I would take Mr. Martin's word for the charge, and put it down in the book the way he told me" (R. 102-103).

Another circumstance reflected by the record is that whenever the surety companies on Tobin's two construction jobs demanded control of the funds for the purpose of paying labor and material bills, Tobin invariably turned to Martin and insisted on Martin acting as his representative in such transactions (R. 99, 108, 103). It is also apparent from Martin's own testimony that he had no hesitancy in undertaking to speak for Tobin in dealing with the surety companies concerning the funds and that he did not deem it necessary to consult Tobin about those matters. In this connection he testified:

> "I did discuss the matter several times with Mr. Hauck in December and January, and I talked with him concerning the execution of some joint control agreement. **Mr. Hauck wanted these funds turned over to the National Surety Company and I told him that Mr. Tobin would not want to do that"** (R. 97).

The Chancellor below who heard the witnesses testify and observed their demeanor on the stand, concluded that the facts reflect that Martin's relation with Tobin in this case was considerably more than that of a mere money lender and that under the test laid down in **Meehan v. Valentine,** supra, relied on so confidently by petitioner, the parties had "joined together to carry on a trade or adventure for their common benefit, each contributing property or services and having a community of interest in the profits." Accord: **Ruggles v. Buckley et al. (C. C. A. 6th), 158 Fed. 950,** holding that a partnership is a fact like any other fact, which may be established by circumstances, and it is not essential to its existence that there should be a partnership name or a formal partnership agreement; and **Causey v. Cottman Co. (C. C. A. 4th), 12 Fed. (2) 558,** wherein the Court states:

> "The testimony as to respondent Leander Langrall being responsible along with the two Causeys is, to our mind, clear and conclusive. He was so related to the transactions, in the light of his connection with the two respondents Causey in this work, and his past association with them in other contracts of a similar character, as to clearly make him liable along with them, certainly so far as third persons are concerned, in this particular transaction. Under this contract he participated in carrying out the same, advancing money to pay bills for the tug and lighter, and for other purposes, and was to have shared in the profits as he had done under other similar contracts."

Another enlightening discussion of the general matter of partnerships is to be found in **Fechtler v. Palm Bros. & Co. (C. C. A. 6th), 133 Fed. 462,** by Judge (afterwards Mr. Justice) Lurton.

Under the circumstances herein outlined, respondents

respectfully urge that the Chancellor's conclusions with respect to the true facts in this case are amply supported by the evidence. The arrangement that existed between Martin and Tobin might be termed a "Joint Enterprise" which is in the nature of a partnership concerning a single venture or transaction (see **Dexter & Carpenter, Inc., v. Houston et al. [C. C. A. 4th], 20 Fed. [2d] 647**).

D.

**An Agent Who Has Violated Specific Instructions of His Principal and Thereby Placed His Principal in a Position Where it is Likely to Suffer Loss in a Transaction, Becomes Liable to His Principal as an Indemnitor for any Loss Resulting From His Wrongful Act and the Agent Cannot Thereafter be Heard to Assert That He Has Acquired Prior Rights in Funds Arising in Connection With Such Transaction for Which He Remains an Indemnitor of His Principal Even Though the Agency Relationship Has Since Terminated, But Will be Required to Account to the Principal for Such Money Thereafter Received by Him in Connection With Such Transaction.**

There are additional equally cogent reasons why Martin cannot be heard to assert his alleged right to these funds. The record reflects the fact that Martin was an underwriting agent for plaintiff, National Surety Company, at the time this bond was executed (R. 80). By the undisputed evidence in this record, appellant, Guy S. Martin, was expressly instructed by the vice-president of the National Surety Company, in charge of its St. Louis office, not to execute the particular bond which is involved in this case. Martin executed it anyway (R. 80). Of course, under

elementary principles of corporation law, an executive officer of a corporation, such as the vice-president in charge of the company's affairs in a particular locality, is the alter ego of the corporation with full authority to control and direct his subordinates. It is equally well established that an agent who disregards explicit instructions of his principal becomes liable to the principal for any loss resulting therefrom. (See **Bank of Br. N. A. v. Cooper, 137 U. S. 473, 34 L. Ed. 759; 2 C. J., Sec. 370.**) So we find appellant Martin, at the time he procured his power of attorney in December of 1932, occupying the position of an indemnitor of the Surety Company, in connection with the identical matter in which he was endeavoring to circumvent the Surety Company's efforts to protect itself against loss.

If the Surety Company should suffer a loss on the job Martin would be liable to the Surety Company for such loss (since he got them into the matter by violating explicit instructions). Under such circumstances Martin could not even be permitted to share with the Surety Company in the funds in question, much less be permitted to acquire rights in derogation of the Surety Company's rights (**American Surety Co. v. Westinghouse E. M. Co., 296 U. S. 133, 80 L. Ed. 31**; see, also, **Trice v. Comstock [C. C. A. 8], 121 F. 620**).

In addition to what has already been said concerning this situation appellant Martin, at the time he violated the Surety Company's instructions and bound it on the bond in question, was acting in connection with a scheme for his own personal gain and enrichment, to wit, to share in the profits arising from the job (R. 138). Even though Martin was discharged as the Surety Company's agent shortly after he executed this bond (R. 80), yet his subsequent advancement of money to Tobin and procuring

the power of attorney in question from Tobin was necessarily a part of the prior plan which arose during Martin's agency for the Surety Company (R. 138), and Martin will not thereafter be permitted to acquire any interest in moneys arising out of the identical transaction, when his principal is thereby caused to suffer a loss, and the former agent would thereby profit from his own wrongful act. As stated in the case of **Commonwealth Finance Corporation v. McHarg (C. C. A. 2), 282 F. 650:**

> "No principle is better established in the law than that loyalty to his trust is the first duty which every agent owes to his principal. It underlies all agencies. The law condemns as contrary to public policy any conduct in an agent which involves a breach of fidelity in that relationship which is most jealously guarded. An agent will not be permitted to place himself in a position where his own interest may become antagonistic to those of his principal. • • •
>
> "And, of course, what the law does not permit an agent to do directly, it will not permit him to do indirectly. He cannot evade the law by causing the property to be purchased ostensibly for another, but in reality for himself. The Court in all such cases looks behind the appearance in which the transaction has been clothed, and will decide the case in accordance with the naked facts, which it has been sought to cover up and conceal" (citing cases).

In the case of **Trice et al. v. Comstock et al. (C. C. A. 8), 121 F. 620,** Judge Sanborn stated:

> "For reasons of public policy, founded in a profound knowledge of the human intellect and of the motives that inspire the actions of men; **the law peremptorily forbids every one who, in a fiduciary relation, has acquired information concerning, or interest in, the business or property of his correlate from using**

**that knowledge or interest to prevent the latter from accomplishing the purpose of the relation.** If one ignores or violates this prohibition, the law charges the interest or the property which he acquired in this way with a trust for the benefit of the other party to the relation, at the option of the latter, while it denies to the former all commission or compensation for his services. This inexorable principle of the law is not based upon, nor conditioned by, the respective interests or powers of the parties to the relation, the times when that relation commences or terminates, or the injury or damage which the betrayal of the confidence given entails. It rests upon the broader foundation, upon that sagacious public policy which, for the purpose of removing all temptations, removes all possibility that a trustee may derive profit from the subject matter of his trust, **so that one whose confidence has been betrayed may enforce the trust which arises under this rule of law, although he has sustained no damage, although the confidential relation has terminated before the trust was betrayed.** • • •

"**And, within the prohibition of this rule of law,** every relation in which the duty of fidelity to each other is imposed upon the parties by the established rules of law in relation of trust and confidence. **The relation of** trustee and cestui que trust, **principal and agent** • • • who, through the employment, gains either an interest in or a knowledge of the property or business of his master, are striking and familiar illustrations of the relation • • •. The law both implies a contract and imposes a duty that the servant shall be faithful to his master • • • the agent to his principal • • •."

(Accord: **2 C. J., Secs. 353-354; Cragin v. Powell, 128 U. S. 691, 32 L. Ed. 566; Dennison & Co. v. Aldrich, 114 Mo. App. 700; Grumley v. Webb, 44 Mo. 444; U. S. v. Carter, 217 U. S. 286.**)

E.

**Where One Who Claims to Have Loaned Money to a Contractor Obtains a Power of Attorney From the Contractor Under an Express Agreement to Collect the Money for the Contractor and to First Apply It to the Payment of All Unpaid Labor and Material Bills on the Job in Connection With Which the Funds Accrued, He Will Be Required to Account to the Laborers and Materialmen and the Contractor's Surety, Who Would Otherwise Be Liable for the Payment of Such Laborers and Materialmen, as Such Funds Will Remain Impressed With a Trust in Conformity With the Agreement Under Which They Were Collected.**

The evidence clearly establishes that the power of attorney which was given by the contractor to Martin was given under an express arrangement whereby he agreed to become primarily a trustee for the benefit of laborers and materialmen on the job.

The contractor, Tobin, testified:

> "On Saturday afternoon I authorized Mr. Martin to go to Washington **to collect that money for me**; I did that because if the money got in your control (referring to the Surety Company), then I would be sitting on the outside looking in" (R. 108).

Tobin also expressly testified that while he had agreed to repay Martin for moneys advanced by Martin, nevertheless the arrangement was that **Martin was not to be repaid** until after Tobin had first paid all of the laborers and materialmen (R. 141). Martin himself made the following admission about the purpose of the power of attorney:

> "**When he gave me the power of attorney he said**

**there were going to be some bills to pay and he wanted me to handle these funds.** I don't know why he wanted me to; he had done that before" (R. 99).

Although Martin's subsequent testimony about the purpose of the power of attorney varies from the foregoing, the trial court chose to believe his admission against interest, and to disbelieve his other explanations to the effect that the power of attorney was given to him to repay his loan. In view of the foregoing evidence, this Court should not hesitate to hold that the funds were impressed with a trust in Martin's hands in favor of respondent.

F.

**The Assignment of a Chose in Action Made by an Insolvent Debtor With Intent to Defraud Creditors, and With a Reservation of Right in Favor of the Debtor, Is Void, and the Grantee Acquires Neither Legal Nor Equitable Rights Thereunder.**

Even if we accept Martin's other explanations, which, in effect, constituted the power of attorney an assignment of Tobin's claim to Martin, it would clearly be a fraudulent conveyance under the facts and circumstances in evidence. The Missouri statutes declaring fraudulent conveyances void provide:

> "Every deed of gift and conveyance of goods and chattels in trust to the use of the person so making such deed of gift or conveyance, is declared to be void as against creditors, existing and subsequent, and purchasers" **(R. S. Mo. [1929 Ed.], Sec. 3116).**
>
> "Every conveyance or assignment in writing or otherwise • • • in goods and chattels or in things in action • • • made or contrived with the intent to hinder, delay or defraud creditors of their lawful actions, damages, forfeitures, debts or demands • • •

> shall be from henceforth deemed and taken as against said creditors and purchasers, prior and subsequent, to be clearly and utterly void" **(R. S. Mo. [1929 Ed.], Sec. 3117).**

The trial court found that Martin's assignment was fraudulent and void (R. 48). The entire transaction bears the following badges of fraud: In the latter part of December, 1932, when Martin procured the power of attorney from Tobin, Martin only claimed a balance due of about $8,200 (R. 96), whereas the funds remaining in the Government's hands which his power of attorney purported to cover, then totaled about $17,000 (R. 101). Therefore, the power of attorney covered more than Martin's claim and, in addition, carried with it a trust in favor of Tobin, the debtor. In this connection Tobin's testimony is interesting:

> "On Saturday afternoon, I authorized Mr. Martin to go to Washington **to collect that money for me.** I did that because, if the money got in your control, then I would be sitting on the outside looking in" (R. 108).

Martin admitted that Tobin reserved the right to revoke the power of attorney (R. 101). In addition to the badges of fraud arising from the fact that the power of attorney covered more than the amount of Martin's alleged debt, and the fact that under the undisputed evidence funds were held in trust for the benefit of the debtor, there is the further significant evidence previously set forth showing Martin's false statements to the effect that Tobin owed him no money and his fraudulent concealment of the fact that he had acquired the power of attorney in question. If this was a good-faith transaction why was it necessary for him to conduct himself as he did? The trial court's finding that this was a fraudulent con-

veyance is amply supported by the facts and is in accord with the authorities. See:

**Batavia v. Wall, 102 Fed. 240;**
**W.-P. Company v. Low, 54 Fed. 93;**
**C. T. Company et al. v. Woodbury, 77 Fed. (2d) 478.**

G.

**Where a General Creditor of the Contractor on a Federal Public Work Holds a Void Written Assignment or Power of Attorney From the Contractor, and by False Statements and Fraudulent Concealment Lulls the Surety Into a Feeling of Security, Directly Resulting in the Surety Delaying the Taking of Any Action, Such Assignee, Upon Thereafter Collecting the Funds From the Government, Is Estopped to Assert That by So Collecting Such Funds He Has Acquired Any Rights Therein Superior to the Equitable Rights of the Surety and of the Laborers and Materialmen.**

In the first place, petitioner Martin was involved with his codefendant Tobin, the contractor, in the prosecution of this public work, as well as the prior Havana post office job. Assuming, for the sake of argument, as Martin does in his brief herein, that the evidence did not establish either a partnership or a joint venture, yet the record in this case reflects that, in addition to having an agreement with Tobin to share the profits, petitioner Martin had personally obligated himself to furnish money to Tobin, as he might need it from time to time during the progress of his federal work projects (R. 138). A fiduciary relationship existed between Martin and Tobin to the extent that Martin not only shared in the profits, but was obligated to furnish Tobin with money. This situation existed at the time Martin bound and obligated the National Surety Company on the bond involved in this case, although

Martin concealed his personal interest in the venture from his principal. In the fall of 1932, when the Surety Company became aware of Tobin's default in payment of labor and material bills on the job, it promptly endeavored to protect its rights by demanding of Tobin that he execute a power of attorney in its favor. This was on December 20, 1932, and, while Tobin promised to see his attorney about the matter, he immediately went to petitioner Martin (R. 108). From the haste with which petitioner Martin then acted in procuring a power of attorney in his own favor (R. 99), it is fair to infer that Tobin told Martin of his own inability to pay claims, and of the Surety Company's demand for protection. Martin also then knew of Tobin's default on the Havana job, as he had undertaken to act as trustee for the Maryland Casualty Company, surety on the job, following the contractor's default in payment of his bills, and the job was completed in October, 1932 (R. 103). From that time until the night of the following February 4th, when Tobin left a conference at which he and his attorney (the present attorneys for Martin) assured the National Surety Company's attorney that it would be promptly given joint control with Tobin over all funds in the Government's hands (R. 86, 87, 108), the record reflects a series of affirmatively false statements by Martin to the Surety Company to the effect that Tobin was not indebted to him in any amount, and fraudulent concealment by petitioner Martin (see **Cosby v. Buchanan, 23 Wall. 420, 23 L. Ed. 137**) of the fact that Tobin had given to Martin the power of attorney or assignment under which Martin later collected the funds (R. 81-87). Martin's power of attorney was void at the time of its execution **(Prairie State Bank v. U. S., 164 U. S. 227)**. Since his subsequent collection of the funds was accomplished by the fraud and concealment just set forth, an equitable estoppel arose. With reference to the doctrine of equitable estoppel, Story states:

"In all of this class of cases the doctrine proceeds upon the ground of constructive fraud or of gross negligence which in effect implies fraud. • • • It has been accordingly laid down by a very learned judge that the cases on this subject go to this result only, that there must be a positive fraud or concealment or negligence so gross as to amount to constructive fraud" **(1 Story, Equity 391).**

To the same purport is the language of the authorities. Thus the Supreme Court of Pennsylvania has stated:

"The primary ground of the doctrine is that it would be a fraud in a party to assert what his previous conduct had denied, when on the faith of the denial others have acted. The element of fraud is essential either in the intention of the party estopped, or in the effect of the evidence which he attempts to set up" **(Hill v. Epley, 31 Pa. St. 334).**

Accord:

**Angle v. C. St. P. M. & O. Ry. Co., 151 U. S. 1;**
**Kirk v. Hamilton, 102 U. S. (12 Otto) 68.**

The Supreme Court of Missouri, in the case of **McNew v. Booth, 42 Mo. 189,** states:

"It is a well settled principle of equity law that where a purchaser becomes such, under such circumstances or state of facts as would make it a fraud to permit him to hold onto his bargain, as by representing that he is buying for the benefit of the embarrassed debtor in the execution, or that he intended to reconvey the property, and thereby obtains it at a sacrifice, the Court will relieve against such fraud; and the person who has gained an advantage by means of such fraudulent act will be converted into a trustee for those who have been injured thereby." (Citing cases.)

**See, also, Grumley v. Webb, 44 Mo. 444.**

H.

**One of the Basic Principles of Equity Jurisprudence Is That One Must Come Into Equity With Clean Hands.**

This principle alone constitutes an insurmountable obstacle to the claim of petitioner Martin. On March 24, 1934, petitioner Guy S. Martin filed a sworn claim in this cause (R. 34), wherein he made affidavit to an honest belief that all of the moneys advanced to Tobin by him were paid for materials and labor that actually entered into the Carlinville, Illinois, post office (R. 38). Just seven days thereafter Martin's deposition was taken in the case of Maryland Casualty Company v. Guy S. Martin, pending in the Circuit Court of the City of St. Louis, Missouri (wherein the Maryland Casualty Company was endeavoring to procure an accounting on the Havana, Illinois, post office job), and in that deposition Martin swore that $5,672.00 of the amount of the claim he filed in the instant case covered advances made for the payment of bills on the Havana post office job. When asked why he included that amount in his claim in this suit he replied, "I wanted to see them paid" (R. 142). See, also, audit of Schuessler, Keller & Co. (R. 136-137). The Supreme Court of the United States in the case of **Brown, Bonnell & Co. v. Lake Superior Iron Co., 134 U. S. 530, 33 L. Ed. 1021,** states:

> "But the maxim, 'he who seeks equity must do equity,' is as appropriate to the conduct of the defendant as to that of the complainant • • •."

In conclusion, the Chancellor who tried this case had an opportunity to see the witnesses and observe their manner in testifying, to determine which of their several conflicting statements most nearly conformed to the facts, and to weigh the credibility of all of the evidence. His decision and conclusions are entitled to great weight upon a review

of the matter by this Court. Premises considered, these respondents respectfully submit that the decree and finding of the trial court and of the Court of Appeals is consonant with equity and justice, and upon authority and reason such decree should by this Court be affirmed.

Respectfully submitted,

J. H. CUNNINGHAM, JR.,
Solicitor for Respondents:
Alton Brick Company,
James Beveridge,
Mississippi Lime & Material Company,
Koerner Engineering Company,
Wenzil Andris,
Schwartz Materials Company,
Usona Manufacturing Company,
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Hunkins-Willis Lime & Cement Company,
The McClelland Company,
H. E. Kennedy,
Robert E. Lancaster,
Peter Vredenburgh Lumber Company,
H. H. Sandman,
Masker Brothers Iron Company,
St. Louis Asphalt Company,
Otto G. Braun,
Straub Bros.,
Walter G. Malham,
Larry Schaff,
Galloway-Von Gruenigen Company,
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